

Taxpayers (and States) Take Notice: Invalidation of the Maryland Digital Advertising Tax Highlights the Importance of the Internet Tax Freedom Act in SALT Litigation

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The Maryland Digital Advertising Tax

A Maryland state court invalidated the state's first-in-the-nation tax on digital advertising (Maryland Digital Advertising Tax) earlier this week.¹ Enacted in February 2021, the Maryland Digital Advertising Tax was controversial even before it became law. The legislation authorizing the tax was vetoed by Maryland Gov. Larry Hogan in 2020 and was enacted only after the Maryland House of Delegates and the Maryland Senate voted to override the veto in early 2021.

The Maryland Digital Advertising Tax is imposed on businesses with at least \$100 million in global revenue and \$1 million in gross receipts from digital advertising services in Maryland.² The tax applies to the annual gross revenues of a business derived from digital advertising services in Maryland. Maryland does not tax nondigital advertising. The term "digital advertising services" is defined to include "advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services." The term digital interface is defined as "any type of software, including a website, part of a website, or application, that a user is able to access."³

The rate of tax imposed by the Maryland Digital Advertising Tax is determined by reference to a taxpayer's annual gross revenues. For taxpayers with global annual gross revenues between \$100 million and \$1 billion, the tax rate is 2.5% of the digital advertising services in Maryland. For taxpayers with global annual gross revenues between \$1 billion and \$5 billion, the tax rate is 5% of the digital advertising services in Maryland. For taxpayers with global annual gross revenues between \$5 billion and \$15 billion, the tax rate is 7.5% of the digital advertising services in Maryland. For taxpayers with global annual gross revenues greater than \$15 billion, the tax rate is 10% of the digital advertising services in Maryland.⁴

Legal Challenges to the Tax

Shortly after enactment, the Maryland Digital Advertising Tax was challenged in state and federal courts in Maryland.

Hours after the legislation was passed, the U.S. Chamber of Commerce and several trade associations, including the Computer & Communications Industry Association, filed a federal lawsuit in the U.S. District Court for the District of Maryland.⁵ The federal case has been fully briefed and awaits oral argument and a decision.

In April 2021, seven divisions of Comcast and Verizon Media Inc. filed a lawsuit in Maryland Circuit Court challenging the Maryland Digital Advertising Tax under the Internet Tax Freedom Act (ITFA) and the U.S. Constitution's due process clause, commerce clause and First Amendment. After recent oral argument on pending summary judgment motions in mid-October, the Maryland Circuit Court (Judge Alison L. Asti) ruled from the bench in favor of Comcast and Verizon. Although a written order will be forthcoming, Judge Asti held that the Maryland Digital Advertising Tax violated ITFA as well as the commerce clause and the First Amendment of the Constitution.

¹ *Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia LLC et al. v. Comptroller of the Treasury of Maryland*, case number C-02-CV-21-000509, in the Circuit Court for Anne Arundel County, Maryland.

² Md. Tax Law. 7.5-103, 7.5-201.

³ Md. Tax Law 7.5-101.

⁴ Md. Tax Law 7.5-103.

⁵ *U.S. Chamber of Commerce et al. v. Peter Franchot*, Case number 1:21-cv-00410 (U.S.D.C., D. Md.).

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Significance of the Maryland Circuit Court's Decision and ITFA's Nondiscrimination Rule

Maryland is not the only state to recently consider a tax on digital advertising revenue. The Maryland Circuit Court's decision and forthcoming order invalidating the Maryland Digital Advertising Tax will certainly inform if and how other states advance legislation enacting new taxes on advertising revenue sourced to their jurisdictions.

The significance of the decision, however, is broader than its effect on how advertisements are taxed. The Maryland Circuit Court's decision identifies the perils that all digital-transaction tax statutes will confront and the importance of the nondiscrimination provision in ITFA to taxpayers challenging such laws.

ITFA was enacted in 1998 to provide a three-year moratorium on both (i) new state taxes on internet service and (ii) "multiple or discriminatory taxes on electronic commerce."⁶ The three-year moratorium was subsequently extended to November 1, 2003;⁷ to November 1, 2007;⁸ to November 1, 2014;⁹ to December 11, 2014;¹⁰ and through October 1, 2015.¹¹ On February 24, 2016, the moratorium was permanently extended.¹² Unless and until the legislation is repealed or materially amended, ITFA will continue to prohibit any new state taxes on internet service and any state taxes that are either a "multiple tax"¹³ or a "discriminatory tax"¹⁴ on "electronic

commerce."¹⁵ In summary, these ITFA rules prohibit a state from enacting (among other tax statutes):

- a tax that results in the same internet transaction being subject to taxation in more than one jurisdiction without an offsetting credit;
- a tax imposed on internet transactions that is not imposed on transactions accomplished through other means;
- a tax that imposes a higher rate of tax on internet transactions than is imposed on transactions accomplished through other means; or
- a tax that imposes any collection or payment obligations for internet transactions that are different from the collection and/or payment obligations on transactions accomplished through other means.

For its first 25 years, ITFA did not play a prominent role in litigation involving state and local taxes (SALT). In light of the increasing importance of digital commerce, the political and fiscal pressures that gave rise to the Maryland Digital Advertising Tax and the importance of the statute in the recent Maryland litigation, ITFA's dormancy is likely over. Both states and taxpayers should prepare for ITFA to play an important role in the resolution and adjudication of SALT controversies.

accomplished through other means; (ii) is not generally imposed and legally collectible at the same rate by such state or such political subdivision on transactions involving similar property, goods, services or information accomplished through other means, unless the rate is lower as part of a phaseout of the tax over not more than a five-year period; (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services or information accomplished through other means; (iv) establishes a classification of internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar information services delivered through other means; (B) any tax imposed by a state or political subdivision thereof, if: (i) the sole ability to access a site on a remote seller's out-of-state computer server is considered a factor in determining a remote seller's tax collection obligation; or (ii) a provider of internet access service or online services is deemed to be the agent of a remote seller for determining tax collection obligations solely as a result of: (I) the display of a remote seller's information or content on the out-of-state computer server of a provider of internet access service or online services; or (II) the processing of orders through the out-of-state computer server of a provider of internet access service or online services.

¹⁵The term "electronic commerce" is defined as "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access."

⁶ 105 P.L. 277, Section 1101(a), Oct. 21, 1998.

⁷ 107 P.L. 75, Nov. 28, 2001.

⁸ 108 P.L. 435, Dec. 3, 2004.

⁹ 110 P.L. 108, Oct. 31, 2007.

¹⁰ 113 P.L. 164, Sept. 19, 2014.

¹¹ 113 P.L. 235, Dec. 16, 2014.

¹² 114 P.L. 125, Feb. 24, 2016.

¹³The term "multiple tax" is defined as any tax "that is imposed by one State or political subdivision thereof on the same or essentially the same electronic commerce that is also subject to another tax imposed by another State or political subdivision thereof (whether or not at the same rate or on the same basis), without a credit (for example, a resale exemption certificate) for taxes paid in other jurisdictions."

¹⁴The term "discriminatory tax" is defined as: (A) any tax imposed by a state or political subdivision thereof on electronic commerce that: (i) is not generally imposed and legally collectible by such state or such political subdivision on transactions involving similar property, goods, services or information

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